The College of Law of England and Wales

Legal Services Policy Institute

February 2010

ALTERNATIVE BUSINESS STRUCTURES: APPROACHES TO LICENSING

Response to the Legal Services Board's Consultation Paper

1. The nature of this response

The College of Law created the Legal Services Policy Institute at the end of 2006 as part of its charitable foundation. Given the College's heritage and growing reputation for strategic leadership in legal education in recent years, the Institute represents its contribution to the process of policy formation and to better-informed planning in legal services by everyone concerned.

This response is submitted on behalf of the Institute addressing the policy and public interest issues raised by the Consultation Paper.

2. Introduction

The Institute is in broad agreement with the LSB's approach to the licensing of alternative business structures as set out in the Consultation Paper. We would wish, however, to express two notes of caution:

(1) To reiterate a point we made in our response to the LSB's earlier consultation on ABSs[1]: any market development, structural response, or ABS licence application that puts (or is likely to put) pressure on the independence of legal advice or on the professional principles must be thoroughly investigated and resisted.

(2) We are surprised that the LSB, in places, expresses a willingness to take significant risks in the implementation of the ABS licensing framework: we refer more specifically to these risks in our responses to Questions 2, 2(d), 6(c) and 11(d) below.

[1] Available at http://www.college-of-law.co.uk/about-the-college/legal-services-policy-institute.html.

3. Responses to the consultation questions

This paragraph sets out the Institute's responses to the specific questions posed in the Consultation Paper on draft guidance to licensing authorities on the content of licensing rules for alternative business structures.

Question 1. What is your view of basing the regulation of ABS on outcomes?

(a) Should all LAs have the same core outcomes?

Yes. There must be a threshold level of regulatory outcomes with which all LAs must require ABSs to comply.

(b) Are the proposed outcomes appropriate?

The proposed outcomes set out in paragraph 37 of the Consultation Paper are broadly appropriate. We make specific comments about particular outcomes in our response to the relevant Questions below. However, it is not clear to us whether the "set of core outcomes" referred to in the second desired outcome of the structure of the licensing framework, and the statement in paragraph 55 that the LSB proposes "to create a set of general outcomes that will apply to all ABS, regardless of LA", are intended as references to the totality of the proposed outcomes in paragraph 37 or to further outcomes yet to be developed.

We are also disappointed that, having criticised respondents to the first ABS consultation for not providing specific examples of models that they thought were high risk (paragraph 46), this Consultation Paper is itself then elliptically vague in paragraph 54 in suggesting that "in some instances relying solely on outcomes or principles will not be appropriate" without giving specific examples.

(c) Is the division between entity and individual regulation appropriate?

We wonder whether it is necessary for LAs to set out in licensing rules outcomes relating to individuals. Those individuals within the ABS who are authorised persons will be subject to the regulations of their appropriate approved regulator; those individuals who are not will be subject to the duties under ss. 90 and 176 of the Legal Services Act (and also to the reporting obligations of the HoLP and HoFA under ss. 91 and 92).

We agree that the entity-level issues set out in paragraph 62 are appropriate for regulatory consideration. We also agree that those set out in paragraph 63 of the Consultation Paper are not (subject to the possibility that they might also affect, say,

issues of integrity and consumer information (e.g., the ABS's marketing practices), and consumer protection (e.g., financial viability)).

It is also important that entity and individual regulation are not regarded as mutually exclusive: there will be instances where both the ABS and one or more individuals within it should be censured for (say) failure of systems and supervision (ABS) and failure to comply (individual culpability).

Question 2. Do you think our approach to the tests for external ownership is appropriate?

We do not agree with the proposition in paragraph 82 of the Consultation Paper that "LAs should take the broad approach that generally ABS will make the achievement of the regulatory objectives more likely". There can, by definition, be no evidence yet of whether such a conclusion can be supported by evidence, and it would therefore be but an act of faith to suggest that such a presumption is risk-based and proportionate. We believe that it would be more appropriate for a regulator to adopt a neutral view that ABSs, as a starting supposition, make the achievement of the regulatory objectives no more or less likely than any other regulated providers of legal services.

We do, however, agree with the later judgement in the same paragraph that it would not be appropriate for an applicant for an ABS licence to show that the ABS would enhance any of the objectives. We believe that any enhancement will be the result of cumulative efforts rather than of the actions of any one ABS.

(a) Should the tests be consistent across all LAs?

Yes. Where a licensable body potentially has a choice about which LA it applies to, its decision should not be influenced by different tests for ownership. Further, where consumers are dealing with ABSs, they should be able to assume that the ownership tests for all such bodies are the same and consistently applied.

(b) Is our suggested approach to the fitness to own test the right one?

Yes, subject to our specific observations in response to this Question and its component parts.

(c) If declarations about criminal convictions are required, should these include spent convictions?

We believe that it is right that declarations about criminal convictions should be required in relation to all matters set out in paragraph 6(3)(a) and (d) of Schedule 13 to the Legal Services Act 2007 (probity and financial position, and any other matter specified in the licensing rules), whether those convictions are spent or not.

(d) What is your view of our suggested approach for considering associates? Is there an alternative approach that would work better in practice?

In broad terms, we support the LSB's approach. However, since it is a statutory requirement in paragraph 6(3)(c) of Schedule 13 to the Legal Services Act 2007 that a LA must (not 'may') have regard to an applicant's associates, we do not believe that a LA should introduce any *de minimis* level of ownership, as suggested in paragraph 102 of the Consultation Paper, below which it will not apply the associate test.

We also do not necessarily agree with the suggestion in paragraph 103 that a LA might presume fitness to own in relation to certain categories of associate. The LSB offers no rationale for this suggestion. If the intention is that such a presumption would apply only to associates who are in some way themselves subject to regulation or approval by other regulators, then that might be acceptable provided that the levels of approval or regulation are commensurate with those required by the Legal Services Act and ABS licensing rules.

Our concern in relation to these issues is that *de minimis* 'exemptions' (even if permitted) and other presumptions might lead to unnecessarily complex ownership arrangements designed to avoid closer scrutiny. At least on initial application for a licence, we believe that LAs might need to adopt a more investigatory function in order to secure the public interest and confidence in new ownership structures achieved through ABSs.

(e) Should there always be a requirement to declare the ultimate beneficial owner of an ABS?

Yes. While there might be some debate about whether this would be appropriate for some types of business activity, the Institute would emphasise that many providers of legal services (whether as registered sole practitioners, recognised bodies, or ABSs) will be critical to maintaining the rule of law and the effective and efficient administration of justice, and in securing access to justice. We therefore believe that it is important for public and consumer confidence that the ultimate beneficial owners of those providers should be known and be a matter of public record.

(f) Overall, are any modifications needed to ensure that our approach work (*sic*) in a listed company?

We support the need for every ABS (including a listed company) to set out in its constitutional documents a hierarchy of duties (first, to the court; second, to the client; and third, to owners/shareholders).

The Institute would also consider it appropriate for LAs to require the disclosure of the existence and terms of any options or charges held over shareholdings and other ownership interests in ABSs, whether at the time of an application for a licence or subsequently.

Finally, we believe that if a shareholder is subsequently deemed not to be a fit and proper person and is divested of their ownership share, that share should be redeemed at the lower of the price paid and its current value. It might be that the actions of that person which lead to them no longer being considered fit to own have caused a decline in the value of the business, and it would be inequitable if they were able, in effect, to profit from their actions by being divested of their share at the price paid rather than the lower current value.

(g) Overall, are any modifications needed to ensure that our approach work (*sic*) in very small companies?

In the absence of a definition or indication of the meaning of 'very small', this is difficult to answer. In principle, we do not think that lack of scale should lead to much (if any) difference to the regulatory approach to external ownership. However, our view would differ depending on whether size is measured relative to, for instance, turnover, capitalisation, number of shareholders, number of employees, or number of authorised persons. On some of these measures, size is not necessarily a sufficient proxy for risk, either to the regulatory objectives or to clients. Our view would also differ if the 'very small' company is part of a group of companies.

(h) Do you think that the definition of restricted interest should change?

We agree with the LSB's approach to the definition of restricted interests.

(i) Do you think that covenants should be required from those identified as having a significant influence over an ABS?

The Consultation Paper does not set out any detail of the possible nature or content of covenants. We do not doubt that such covenants could be useful. However, given that the statutory and licensing framework is robust, we think that the same result could probably be achieved by requiring a written declaration from all non-

authorised persons (possibly as part of the licence application) that they are aware of and agree to abide by their statutory duties in ss. 90 and 176 of the Legal Services Act and the terms of the ABS licence. Notifications of changes of ownership could contain similar declarations. Where there are particular concerns, either with initial applicants or later owners or officers, the imposition of conditions on the licence might be more appropriate than covenants.

(j) How should the LSB respond to the information it receives about information on action taken against people that falls short of disqualification?

The Institute believes that it is difficult to be prescriptive about this. Much will depend on the nature of the information, the credibility of the source (assuming that this Question is not intended to be confined to information from other regulators), and the potential consequence of the information (if true) on the person concerned and their position in an ABS. At the least, it seems likely that the information should be passed to the appropriate LA and, if relevant, to the approved or other regulator of the individual. The LSB might wish to carry out some due diligence or further investigation of the information received (or of its source) before passing it on; having passed it on, it might wish to require a response from the LA on the action taken (if any) within a specified timescale. Finally, the LSB might wish to compile and retain a register of such information received, which LAs would be expected to consider as part of the issue or renewal[2] of ABS licences.

Question 3. Do you have views on how indemnity and compensation may work for ABS?

(a) How should an appropriate level of PII be set for ABS that are carrying out a variety of different activities, not all of which are currently regulated by the ARs?

This issue may be closely related to the question of whether or not ABSs should be allowed to carry out non-reserved legal activities in one or more separate entities to their reserved (licensed) activity or activities (see Question 4(b) below). We believe that the level of cover required for all legal services offered by an ABS (whether reserved or non-reserved) should, in the public interest and in the interests of consumers, be the same as that required of law firms.

There could also be a related issue where an ABS, as a multidisciplinary business, also offers other (non-legal) services. If those services are regulated by other (non-

[2] In light of the Board's proposal for indefinite licences (see Question 14), a LA might be expected to consult this register on an annual (or other periodic) basis when the licence fee is paid.

AR) regulators, and PII cover for those services is required by those other regulators, then we believe that the ABS should also be obliged to carry the same cover. As with the distinction between reserved and non-reserved legal activities, we should be concerned if ABSs were effectively encouraged to 'hive off' their non-legal services if by doing so they could secure a less onerous regulatory solution.

In all cases, the Institute believes that the general principle should be that the consumer receiving any service from an ABS should not be in any less advantageous position, or have any less protection, than if he or she were receiving those services from other forms or combinations of regulated entity. Where, for some reason, insurance cover does not extend to the services received by a client, the client should be made aware of that.

(b) Should there be minimum PII levels, which are the same for all LAs for different types of activity?

Consistent with the general principle set out in our response to Question 3(a) above, parity of cover for the same service is desirable in the interests of clients, irrespective of the AR or LA. The ABI research referred to in paragraph 138 of the Consultation Paper suggests that minimum cover of £1 million for firms operating in the 'consumer' or 'retail' markets with individuals for clients would perhaps be appropriate (with a higher level for firms acting for businesses or 'high net-worth' individuals). Regulated businesses would then be free to seek higher levels of cover when this is consistent with their assessed business interests or risk profile. It might be that, in certain circumstances, a LA might wish to reserve the power to make PII cover in excess of the minimum a condition of an ABS licence.

(c) Are master policy arrangements appropriate for ABS?

We do not believe that master policy arrangements should be required for ABSs. The source of cover should be a matter for the market and individual ABSs. Where minimum cover proves not to be available for an ABS, there will usually be good reason – that is, a perception of increased or unacceptable risk.

(d) What would be appropriate arrangements for run off and successor practices to enable sufficient commercial freedom for ABS as well as protection for consumers after practice closure?

This question raises a difficult balancing act. Protection of clients following the closure of a firm is vital; however, current SRA practice can act as a disincentive to both mergers and orderly exits of law firms. The 'successor practice' rules (and associated costs) can deter firms from acquiring or merging with firms that wish to

close. The run-off cover requirement can also deter practitioners who wish to retire or close their firms from being able to do so. In some circumstances, this might even lead to firms that are barely viable effectively remaining in business as the 'least-worst' option, which might also not be in clients' interests. Careful consideration by the LSB and the SRA of the appropriate minimum level and period of run-off cover might help to reduce the economic burden of closure on those firms that wish to close. Allowing an acquiring firm to elect to become a successor practice (rather than imposing that outcome) might also ease the path to more merger and consolidation of smaller or questionably viable firms. In all cases, therefore, the ultimate obligation to secure run-off cover would remain with the firm that ceases its independent existence for whatever reason.

(e) What should the requirements be for compensation funds in ABS?

In the short term at least, given the uncertainty about the take-up of ABS licences and the possible costs to licensees of establishing a compensation fund, we see fidelity guarantee insurance as the most pragmatic route to compensation. We do not favour the use of interest on client accounts (on the basis that this effectively deprives all clients of money that is rightfully theirs), and we would see the potential liquidity disincentive of bonds as a likely deterrent to entry for some prospective ABSs.

(f) How could a compensation fund work in an ABS environment, in particular when the services offered by the ABS may be much wider than legal advice and where an AR may not currently have a compensation fund?

In principle, the Institute believes that all legal activities of an ABS (whether reserved or non-reserved) should be subject to compensation. As with PII cover, we would also not wish to see any incentives to ABSs to 'hive off' some of their non-legal activities, but would nevertheless prefer to see all legal and non-legal activities covered by compensation arrangements. However, given that the primary purpose of ABS licensing is to regulate an ABS's legal activities, if its non-legal activities would not, in other business structures, be the subject of compensation arrangements and are sufficiently distinct (or disconnected) from the legal services, then there is a strong argument for not requiring compensation arrangements for those non-legal services – provided the client is expressly informed that this element of the ABS's activity is not covered.

Question 4. Do you agree with our position on reserved and non-reserved legal activities?

(a) Do you agree that ABS should be treated in a consistent way to non-ABS?

Yes. ABSs should be in no better or worse position than other regulated providers of legal services, either in relation to regulation or competition.

(b) Should all legal activities undertaken by an ABS be regulated or just reserved legal services?

All legal activities of ABSs should be regulated, on the basis that they should be in no better or worse position than other regulated providers of legal services. The remaining potential competitive disadvantage as between regulated providers of legal services and unregulated providers of non-reserved legal services adds some urgency to the LSB's forthcoming review of the extent of reservation.

(c) What role do you see consumer education playing?

Consumer perception and experience will be key to the success of a more open market for legal services. However, any requirements or exhortations on regulated providers to engage in consumer education (either as an ancillary consequence of their commercial activities or as part of their *pro bono* or corporate social responsibility initiatives) will inevitably impose a disproportionate burden and responsibility on them as compared to the unregulated providers of non-reserved services. Although we share the wish not to see regulatory costs at a higher level than necessary, we consider that the promotional 'critical mass' or buying power that could be achieved by the LSB (either alone, or in combination with all ARs and LAs) suggests that the Board must take the lead role on consumer education as part of its duty to advance the regulatory objective in s. 1(1)(g) of the Legal Services Act of "increasing public understanding of the citizen's legal rights and duties".

(d) How should ABS which are part of a wider group of companies be treated?

As stated in our response to Question 3(a) and (f) above, the Institute believes that the general principle should be that the consumer receiving any service from an ABS should not be in any less advantageous position, or have any less protection, than if he or she were receiving those services from other forms or combinations of regulated entity. The primary purpose of ABS licensing is to regulate an ABS's legal activities. If a group's non-legal activities are sufficiently distinct (or disconnected) from the ABS's legal services, then there can perhaps be little room for suggesting that the ABS and its legal (or even any non-legal ancillary) services or activities are

not properly constituted and regulated, and the group's other companies are then clearly beyond the reach of legal services regulation. However, in the interests of consumers (and consistent with some obligation to educate and inform), we do not believe that it would be unreasonable or unduly burdensome for an ABS referring one of its clients to another group company to be required to make the client aware that the other company is not regulated by the ABS's legal services licensing authority and that the levels of protection and procedures for complaint and redress are different.

Question 5. Are the enforcement powers for LAs suitable?

(a) What is your view on the proposed maximum level of financial penalty that a LA can impose on an ABS?

The Institute agrees with the proposal for an unlimited penalty.

(c) Will LAs have sufficient enforcement powers?

The Institute believes that the broad range of enforcement powers and responses available to LAs will prove sufficient. However, the practice of different LAs in applying their enforcement powers will need to be as consistent and comparable as possible in order to provide transparent, risk-based and proportionate enforcement. We would also expect that LAs would be in a position, through disclosure and effective monitoring, to apply their powers such that the more draconian of them would be used only as a last resort and in the face of either deliberate culpability (rather than inadvertent transgression), or fundamental breaches of the Act's requirements or licence terms.

A common appeals process across LAs would also help in the development of a transparent and comparable approach.

(d) Will ABS have sufficient clarity as to how the enforcement powers may be used?

As a consequence of our view expressed in response to Question 5(c) above, we would hope that clarity would emerge over time. It would be preferable for this clarity to emerge sooner rather than later, if potential ABSs are not to be deterred from seeking licences because of perceptions of any lack of clarity, disproportionate use of powers, or inconsistency as between LAs.

(e) In what circumstances should a LA be able to modify the terms of a licence?

Modification would seem to us to be the natural consequence of a LA becoming aware of information or circumstances which, had it known those facts at the time of the application for, or grant or renewal of, a licence, the licence terms would have been different, and modification is now required to reflect current knowledge.

(f) Are there appropriate enforcement options for use against non-lawyer owners?

The Institute judges that the Legal Services Act sets out a generally robust framework for the licensing and regulation of ABSs which, if implemented in practice, will provide appropriate enforcement options. In particular, we believe that the powers to impose conditions on licences, to modify licences, to suspend or revoke licences, to impose penalties, to disqualify managers or employees[3], and to restrict or divest ownership interests, represent a formidable array of options that should discourage inappropriate activity or behaviour by non-lawyers.

Question 6. What do you think of our approach to access to justice?

(a) Do you think the wide definition to access to justice that we have taken is appropriate?

We set out at some length our views on access to justice in the context of the Legal Services Act in our response to the first LSB consultation (see pages 31-34 of our first response[4]). Hopefully, it will be apparent from those views that we favour the broad definition, though we would respectfully point out that the current Consultation Paper focuses rather more on the meaning of 'access' than of 'access to justice'.

(b) Is asking an ABS on application how they anticipate that they will improve access to justice a suitable approach?

On balance, the Institute is not persuaded that this is a suitable approach. It is not a statutory requirement that each ABS should seek to improve access to justice (and nor do we believe that it should become a licensing requirement). To ask such a question on application would, therefore, suggest that a LA might believe that improving access to justice should be a significant factor in granting an ABS licence, or presents a justification for refusing one or attaching a condition. We therefore

[3] We further suspect that the power to disqualify the ABS's HoLP and HoFA under s. 99 would also represent a potent disincentive to inappropriate behaviour or pressure by non-lawyer owners who might find themselves subsequently struggling to recruit a new HoLP or HoFA who would meet their LA's 'fit and proper' test.

[4] Available at http://www.college-of-law.co.uk/about-the-college/legal-services-policy-institute.html.

suggest that, as envisaged by Question 6(d), a LA (and the LSB across all LAs) should consider how ABSs in general contribute to improving access to justice rather than trying to assess the impact of any one ABS. However, we would have no objection to a LA inviting an ABS applicant to answer the question as part of a voluntary addendum to an application.

(c) Do you agree that restrictions on specific types of commercial activity should not be put in place unless there is clear strong evidence of that commercial practice causing significant harm?

The object of the 'significant harm' referred to is not stated. We therefore assume in answering this question (even then without seeking to be exhaustive) that it might be to one or more of:

- clients of the ABS;
- consumers or the consumer interest in general;
- the public interest; access to justice;
- the wider market; or
- (as a catch-all) the regulatory objectives or professional principles in the Legal Services Act.

In any of these cases, we should be reluctant to state that restrictions should only be considered or placed on activities leading to such harm only when there is 'clear strong evidence' of cause. We agree with the statement in paragraph 218 of the Consultation Paper that it "is not the job of a regulator to position general barriers on the basis of theoretical risks"; but we see a distinction between 'theoretical risks', on the one hand, and 'reasonably foreseeable risks' based on an understanding of the market, on the other. We believe that it is justifiable for a regulator to act in anticipation of a perceived, reasonably foreseeable, risk (as well as in relation to an actual or materialised risk), especially where to do so would prevent the significant harm to the objects suggested above.

We agree with the LSB's approach in not allowing LAs to impose or suggest cross-subsidies or requirements for *pro bono* activity, or allowing them to use interest on client money to fund access to justice initiatives. We also strongly support the position in paragraph 221 of the Consultation Paper that any regulatory intervention to address 'cherry picking' of more attractive or profitable legal services is not appropriate or justifiable.

(d) Do you agree that LAs should consider how ABS in general impact access to justice rather than trying to estimate the impact of each application singularly?

Yes: see our response to Question 6(b) above.

(e) Do you agree that LAs should monitor access to justice?

Yes: without such monitoring, it will be difficult to see how the regulatory objective of improving access to justice is being achieved. We agree that part of a LA's annual reporting to the LSB would be a proper vehicle for feedback[5].

Monitoring might be taken to include some measurement against benchmark performance to provide comparisons as between different LAs, relative to other jurisdictions, or in relation to trends over time. Such an approach would lead to two initial challenges which the LSB might wish to address: first, a definition of 'access to justice' that can be adopted by all LAs (and equally by all ARs and others with a duty or an interest in this regulatory objective)[6]; and, second, establishing a set of metrics or other forms of assessment against which improvement can be measured. Neither of these challenges is straightforward, and might be appropriate for consideration by the LSB's Research Strategy Group.

Question 7. What is your view of our preference for a single appeals body?

In the interests of establishing a common body of meanings and practice across all LAs in relation to ABSs, and more generally for all issues within the LSB's remit, the establishment or identification of a single appeals body has great merit. The GRC strikes us as an appropriate body to hear appeals, and would wish to see the LSB advance its discussions with a view to establishing such an appeals process before the ABS licensing framework is operational.

Question 8. Do you agree with our approach to special bodies?

(a) Do you think that special bodies' transitional arrangements should come to an end?

In principle, the Institute believes that the protection available to clients should be the same, irrespective of the body through which legal services are provided, and we

[5] In turn, as we suggested on page 34 of our response to the first consultation, "the Board should expressly include within its annual report under section 6 of the Legal Services Act an assessment of the effects on access to justice of developments generally and of ABS licences particularly".

[6] We are not convinced that the description of access to justice set out in Annex 1 to the LSB's draft business plan for 2010/11 is sufficiently detailed for this purpose.

therefore agree with the LSB's objective as stated at the beginning of paragraph 259 of the Consultation Paper. We acknowledge the regulatory gap created by the inability to regulate the provision of non-reserved services by non-authorised persons, but beyond that would wish to see other providers as either recognised or licensed bodies.

There is a statutory basis in the Legal Services Act for a transitional period for special bodies *other than* low-risk bodies within s. 108 (following the effects of ss. 23 and 106(1)). We certainly understand the rationale for providing special bodies with a transitional period before they would be required to apply for an ABS licence, but would nevertheless wish to see an end to that period as quickly as possible. However, as we read the Act, the introduction of the ABS licensing framework *must* apply to low-risk bodies, subject only to the ability of LAs to determine that their licensing rules apply *differently* (rather than not at all, or not for a period after their introduction for other applicants)[7]. We therefore see no statutory basis for any transitional period in relation to low-risk special bodies.

(b) Do you think 12 months after the start of mainstream ABS is sufficient time for them to gain a full licence?

If there is to be a transitional period (see our response to Question 8(a) above), we believe that 12 months should be sufficient time. Further, we would not wish to see a special body that wished to apply within that (or any other transitional) period being prevented from doing so.

(c) Do you think LAs should adapt their regulation for each special body?

Subject to the specific statutory differences (such as those applying to trade unions in s. 105 of the Act), in the interests of consistency and the avoidance of potential confusion for consumers, we would wish to see as few other differences as possible. It may be that LAs could justify differences as between 'mainstream ABSs' and special-body ABSs, and as between certain types of special body (in which case, we would also expect to see those differences reflected in the licensing rules of all LAs). However, we would not welcome further differences for individual special-body ABSs.

We have no wish to see the viability jeopardised of some of the special bodies (particularly the not-for-profit organisations) who often support access to justice for vulnerable people. Nevertheless, we think it is right that the special body treatment

[7] Given the express language of paragraphs 7 and 8 of Schedule 11 to the Legal Services Act, which require that licensing rules *must* make provision in relation to special bodies, it is difficult to see how the Board can approve licensing rules without those provisions for low-risk bodies, contrary to the thrust of the suggestion in paragraph 246 of the Consultation Paper.

accorded to them should neither relieve them of the fundamental obligations that apply to other providers of legal services to members of the public nor impose on them regulatory or economic burdens that are disproportionate to the risk they present.

(d) Do you agree there are some core requirements that all special bodies should meet? If so, what do you think these are?

In principle, we believe that the core requirements should be those that are necessary for achieving the Act's regulatory objectives and maintaining the professional principles.

(e) What are your views on the suggestion that the OLC should make voluntary arrangements with special bodies?

The absence of a complaints process would be merely a continuation of the current situation and therefore arguably no more detrimental to consumers. Even so, it seems difficult to suggest that voluntary arrangements with the OLC should not be entered into covering those special bodies that choose not to apply for an ABS licence.

Question 9. Do you think that our approach to HoLP and HoFA is suitable?

(a) Do you think that our approach to focussing on compliance systems across the organisation is suitable?

While a focus on compliance systems is to be welcomed, the Institute would be concerned if compliance with systems became the predominant basis of any judgement. In our view, compliance and ethical behaviour are ultimately states of mind rather than functions of structures or systems. There have been too many instances in recent times of professed conformity to 'the system' or 'the rules' (the miners' compensation cases, and Parliamentary expenses immediately come to mind) but where the underlying ethicality of behaviour has been absent or dubious. Such instances of 'What can we get away with?' rather than 'What is the right thing to do?' should not be encouraged in the licensing of ABSs.

(b) Do you think that HoLP and HoFA should undergo a fit and proper test?

We disagree with the wording of paragraph 270 of the Consultation Paper that licensing rules "may" make provision about a 'fit and proper' test, and therefore with the substance of this question. Paragraphs 12(1) and 14(1) of Schedule 11 to the

Act require that the licensing rules "must" contain the appropriate provisions. Question 9(b) is not therefore, in our view, a legitimate one for consultation.

The appointments of HoLP and HoFA are not merely matters of commercial or organisational judgement. These roles (for good reason) carry significant regulatory authority and responsibility. Further, the ability of a LA to withdraw its approval of or to disqualify a HoLP or HoFA under, respectively, paragraphs 11(6) and 13(6) of Schedule 11 to, and s. 99 of, the Act suggests to us some preliminary obligation on a LA to specify the nature of both its assessment of 'fit and proper' and its later judgement of whether the HoLP and HoFA have discharged their duties under the Act.

In paragraph 265 of the Consultation Paper, the LSB suggests that the test for HoLPs and HoFAs should be the same as that for owners. However, in paragraph 274, there is no reference to the provisions relating to associates that apply to owners. We believe that the associates of a HoLP and HoFA are an equally relevant factor in considering the fitness of someone to hold these important posts. As with owners (see our response to Question 2(d) above), we would not support the use of any *de minimis* or other exemptions.

(c) Should there be training requirements for the HoLP and HoFA?

The Institute believes that the roles of HoLP and HoFA are critical to the effective functioning and regulation of ABSs – such that no semblance of a 'light-touch approach' to the approval of their appointment or to the LA's assessment of the discharge of their duties should be evident. We therefore expressed our view on this issue in our response to the first consultation (at page 28) by suggesting that both the HoLP and HoFA should "either demonstrate that they have undertaken a (short) programme that equips them to understand the professional and regulatory framework of an ABS, or undergo an interview with the licensing authority to demonstrate that understanding (or both)". We remain of this view.

We also think that it would be both desirable and appropriate for a LA to set out the minimum or indicative qualification or competence that it would expect a HoLP and HoFA to demonstrate (irrespective of whether competence is a requirement of the LA's approval of their appointment). In this way, although applicants will have some degree of commercial latitude in the set of skills they choose to seek in the persons they wish to appoint to these roles, they will then also have a sense of whether the LA's minimum expectations are met (and so whether any additional or continuing training would be sensible). Such an approach would also be consistent with regarding the roles of HoLP and HoFA as 'significant influence functions' (in the way described on page 28 of our response to the first consultation). Finally, for those ABSs who choose to appoint the same person to both roles (see our response to Question 9(d) below), this approach would also ensure that an authorised person

suitable for appointment as a HoLP was indisputably aware of the additional competence (and therefore training) expected of a HoFA[8].

(d) Do you agree that the HoLP and HoFA could be the same individual (especially in small ABS)?

The Institute accepts that there may well be circumstances (say, for small[9] ABSs and some special bodies) where the requirement to appoint different individuals to the roles of HoLP and HoFA could be disproportionately burdensome. Given that the HoLP must be an authorised person in relation to at least one of the ABS's licensed (reserved) activities (paragraph 11(3)(b) of Schedule 11 to the Legal Services Act), in a dual appointment the HoFA will necessarily be a lawyer. The need for an understanding of the competence required of an effective HoFA and possibly training (as discussed in our response to Question 9(c) above) becomes more important. Indeed, it could be argued in the case of a dual appointment that mandatory evidence of accreditation, certification or education in the role of HoFA should be a precondition to the LA's approval of a dual appointment or a condition of the ABS licence.

Question 10. Do you think that our approach to complaints handling is suitable?

(a) Do you think that ABS complaints should be handled in the same way as non-ABS complaints?

The Institute expressed the view in its response to the first consultation (on page 36) that the approach to complaints handling by 'new entrant' ABSs might be more consumer friendly and helpful. In this pragmatic sense, therefore, ABS complaints arguably should be handled differently. From a regulatory perspective, however, we believe that the formal mechanisms for first-tier handling of complaints and their subsequent consideration by the OLC should be consistent as between the providers of legal services[10].

[8] It is the possibility of such a joint appointment that leads us to believe that it is potentially unreliable to proceed on the basis that a HoFA will normally be a qualified accountant. Arguably, there is a greater need for regulatory assurance in relation to the HoLP/HoFA's competence in a small or uncommon ABS where the roles are combined.

[9] We note that the LSB does not as yet offer any definition or indication of what 'small' would mean: we repeat our observation from Question 2(g) above that size is not necessarily a sufficient proxy for risk.

[10] Subject (as always) to the absence of a complaints-handling process in relation to non-reserved services delivered by unregulated providers.

(b) Do you think that ABS should be allowed to adapt their complaints handling systems if they already have one for their non-legal services consumers?

For the reasons suggested at the beginning of our response to Question 10(a) above, the Institute believes that ABSs should be allowed to adapt their other complaints-handling processes. This might need to be subject to a caveat that such processes must comply or be consistent with any guidance issued by the ABS's LA along the lines suggested in paragraph 295 of the Consultation Paper.

(c) Do you think it is appropriate for the OLC [to] take complaints from multidisciplinary practice consumers and refer where necessary?

As an extension of the OLC's role in referring misconduct or discipline issues relating to an authorised person to their relevant individual regulator, we do think that it would be appropriate for the OLC to refer on complaints relating to non-legal services to any relevant regulator or authority.

Question 11. What are your views on our proposed course of action to conduct research and, depending on the results, either compel transparency of data or encourage it?

(a) Do you agree with our position on diversity and ABS?

The Institute does not know whether the issue or consequences of diversity in legal services is necessarily better or worse with ABSs: indeed, we think that it is simply too soon for anyone to know or to offer any conjecture.

(b) Do you agree that the overall impact is unlikely to be adverse to the diversity of the profession?

As suggested in our response to Question 11(a) above, we are able neither to agree nor disagree, on the basis that we not believe that it is yet possible to know or suspect with any degree of confidence.

(c) Do you agree that non-lawyer managers may open new career paths to lawyers and these may have a positive impact on career progression?

While we agree that the structure of ABSs might open new career paths to lawyers (in both legal and non-legal roles), we do not see that non-lawyer managers *per se* are likely to do so – unless by virtue of their ownership or senior management positions in ABSs. We certainly welcome alternative career paths for lawyers arising from

ABSs, and for the individuals involved there is potential for a positive impact on career progression. However, we are inclined to doubt whether the overall effect on the employment market for lawyers will show any significant improvement in career progression or prospects. While there might be an increase in the number of ownership opportunities (compared with the current, largely partnership-driven, model), the likelihood is that the relative percentage of ownership achieved will be much lower on average. We come to this conclusion in the belief that the preferred structure for new-entrant ABSs will be a limited company rather than a partnership, and that this form will result in more widely distributed ownership than in partnerships (and will possibly include ownership opportunities for support staff as well as lawyers).

It also seems likely that the opportunities for senior management involvement by lawyers will be fewer than has been the case (on the basis that, with the exception of a HoLP who must be a lawyer, non-lawyer owners and investors will prefer to see professional managers in management positions) – although again the opportunities offered in the future might be more significant and meaningful for the individuals who are involved.

(d) Do you agree that the demand for diverse legal professionals will, largely, offset the potential impact due to the closure of small firms?

Consistent with our response to Question 11 (a) and (b) above, we can neither agree nor disagree. However, to contemplate, as suggested in paragraph 308 of the Consultation Paper, that the closure of BME firms in the face of competition from ABSs is an acceptable risk to take *in anticipation* that such losses *might* be compensated (or, in this Question's language of carbon-neutrality, 'offset') by the *presumed* need in the market generally for a diversity of individuals strikes us as an act of faith – if not gamble – not supported by evidence.

In the Institute's view, the risk to BME firms is as likely as that to small firms generally or, for instance, of the replacement of authorised persons in some firms with paralegals who are not legally qualified. Indeed, it could also be argued that small firms are more likely to accept part-time and flexible working, and the risk to these firms represents a disproportionate risk to gender diversity. We regard all of these as equivalent risks, would not describe them as 'acceptable', and do not think that any general need for diversity will necessarily 'offset' these risks. On balance, we believe that developments in the legal services market will favour diversity of qualification and experience above diversity based on gender, ethnic background, and the more normally understood meaning of 'diverse'.

(e) Should the LSB require information about the diversity of the workforce in ABS? If so when and should this be a requirement for other legal service providers?

In principle, the Institute's view is that the composition of an organisation's workforce should be a commercial matter resulting from its selection of the best qualified and most suitable candidates, subject to compliance with anti-discrimination provisions. We therefore suggest that the submission of any information should be encouraged rather than required. We also believe that, whatever approach is taken, it should be the same for all regulated providers of legal services.

Question 12. Do you agree with our approach to international issues?

The Institute agrees with the LSB's approach. Many regulators and representative bodies of lawyers in other jurisdictions are opposed in principle to the reforms of the Legal Services Act. Their objections are philosophical and political, and deep-rooted. They are largely based on the independence of lawyers, and the presumption that the reforms will inevitably compromise that independence. There is some force in the objections, but they overlook other forms of compromise that already exist in their current 'independent' arrangements which also hold the potential to encourage behaviour that is not in the best interests of clients or consistent with other professional standards (including the over-dependence of a lawyer or firm on a large client or source of business, economic competition for work or profit-shares among partners in the same firm, and competition for clients among law firms).

The LSB will need to promote the success of the reforms in England and Wales as evidence that the world of legal practice does not fall in, or unethical pressure or behaviour run amok, when non-lawyers are allowed a greater role in the ownership and management of law firms. This will all depend, of course, on the LSB being able to secure such a benign outcome through its effective supervision of approved regulators and licensing authorities. Only in this way is it likely to persuade sceptics in other parts of the world and, in time, allow leading law firms in England and Wales to adopt ABS structures and opportunities with confidence that this will not affect their global operations or require Byzantine ownership structures to accommodate them.

Question 13. Should LDPs, Recognised Bodies and other similar firms have transitional arrangements into the wider ABS framework in the way we propose?

(a) Is 12 months after the start of mainstream ABS sufficient time to allow this to happen?

The Institute believes that 12 months should be a sufficient period for transition. We also assume that, even if there is a transitional period, any given firm would not be precluded from applying for a full licence before the end of that transitional period.

Further, some non-lawyer LDPs (that is, those with less than 10% non-lawyer involvement) might wish to apply to become 'low-risk' ABSs[11]: again, we do not consider there to be any merit in preventing such bodies from applying to be ABSs because of the existence of a transitional period.

Question 14. Should ABS licences be issued for indefinite periods?

(a) Should the annual charging process be broadly cost reflective or a fixed fee?

The Institute would support the principle of indefinite licences. We understand that there is a duty on an ABS to notify its LA of any changes, and that accordingly an annual renewal process could be unduly cumbersome. However, given that the LSB envisages an ABS paying an annual fee[12], we would suggest that (to guard against oversight or inadvertent failure to notify) there should be a requirement on an ABS as part of the process of paying its annual fee to certify – possibly by signature of the HoLP – that there have been no changes to the information submitted as part of its original application for a licence (or last annual payment).

We believe that the annual charging process should be broadly cost reflective, allowing for differential licensing fees. We further suggest that this might go beyond differences for *types* of ABS and extend to differences for a *particular* ABS. This would allow a LA to impose a higher licensing fee where, for instance, one or more conditions has been attached to a licence and subsequent monitoring costs could be higher to reflect a perceived risk.

(b) How should LAs ensure ABS are continuing to comply with their licence requirements?

The Institute believes that compliance can be achieved through a combination of:

[11] See also our response to Question 8(a) above.

[12] We note that the Act refers to a 'periodical fee' rather than an annual fee (paragraph 21(1) of Schedule 11 to the Legal Services Act), so it would also be possible to contemplate (say) a three-year or five-year 'renewal'.

- timely notification by ABSs of any changes in their ownership, management, structure or activities (including the annual self-certification suggested in our response to Question 14(a) above);
- timely follow-up by LAs when they receive credible information from or about ABSs that puts them 'on notice' of any breach or increased risk; and
- effective monitoring visits to ABSs – especially where conditions have been attached to any licence or a LA has had cause to modify the terms of a licence.

Question 15. Do you agree with our approach to managing regulatory overlaps?

(a) Is it desirable to have a framework approach to a MoU?

We believe that transparency and consistency as between regulators will be important, as well as avoiding unnecessarily burdensome compliance costs for ABSs offering multiple services. A framework approach to a MoU appears to us to be a sensible way of proceeding.

(b) Do you think we have identified the right bodies to develop a MoU with?

The list suggested in paragraph 356 of the Consultation Paper represents a good starting point, although other bodies might emerge over time.

(c) Do you think we have identified the right issues to include?

The areas set out in paragraph 357 of the Consultation Paper are appropriate. We suggest that a communication protocol and information-sharing processes between and among parties to the MoU might also be included.

4. Confidentiality

We do not wish our views to be confidential and have no objection to our responses being attributed.

The Legal Services Policy Institute

The Legal Services Policy Institute (LSPI) was established by the College of Law in November 2006. Its principal objectives are to:

(a) seek a more efficient and competitive marketplace for legal services, which properly balances the interests of clients, providers, and the public;

(b) contribute to the process of policy formation, and to influence the important policy issues, in the legal services sector and, in doing so, to serve the market and public interest rather than any particular party or sectional interest;

(c) alert government, regulators, professional bodies, practitioners and other providers, and the wider public, to the implications of these issues; and

(d) encourage and enable better-informed planning in legal services by law firms and other providers, government, regulators and representative bodies.

The Institute seeks to form and convey independent views; where the College might have views as a provider of education, these are expressed separately.

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